Supreme Court, U.S.
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No. 93-1710

In The

Supreme Court of the United States

October Term, 1993

PHILIP MORRIS INCORPORATED
(d/b/a PHILIP MORRIS U.S.A.),

Petitioner,

v.

CABARRUS COUNTY, NORTH CAROLINA,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of North Carolina

RESPONDENT'S BRIEF IN OPPOSITION

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ROBERT H. TILLER
(Counsel of Record)
CHARLES C. MEEKER
PARKER, POE, ADAMS & BERNSTEIN L.L.P.
One Exchange Plaza
Post Office Box 389
Raleigh, North Carolina 27602
(919) 828-0564

DAVID L. TERRY
BLAKENEY & ALEXANDER
3700 NCNB Plaza
Charlotte, North Carolina 28280
(704) 372-3680

Attorneys for Respondent Cabarrus County

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

Whether a local government may pay for property tax auditing services on a percentage-fee basis without violating the requirements of the Due Process Clause of the Fourteenth Amendment.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Cabarrus County, North Carolina, respectfully requests that the Court deny the petition for a writ of certiorari seeking review of the opinion of the Supreme Court of North Carolina reported at 335 N.C. 227, 436 S.E.2d 828 (1993).

JURISDICTION

Petitioner has sought review under 28 U.S.C. § 1257. The decision below should not, however, be deemed final within the meaning of this statute. *See infra* pp. 13-14. For

this reason, the case does not lie within this Court's jurisdiction.

STATEMENT OF THE CASE

Cabarrus County is a largely rural county of approximately 100,000 residents in central North Carolina. As its primary source of revenue, the County taxes real and personal property, and requires all taxpayers to list their property as of January 1 each year. For owners of business personal property, such as a cigarette manufacturing facility with extensive machinery and equipment, the County requires that 100 percent of the original historic costs of this equipment be listed, along with the year of acquisition. The County then applies trending tables recommended by the North Carolina Department of Revenue to depreciate these costs. Property tax assessments are made on the basis of these depreciated amounts.

Under North Carolina statutes, each county assessor is required "to see that all property not properly listed during the regular listing period be listed." N.C. Gen. Stat. § 105-312(b). Whenever an assessor finds unlisted or underlisted property, he must issue a discovery assessment. *See id.* § 105-312(d).

Prior to 1988, Cabarrus County did not audit business personal property taxpayers. In response to concerns about possible underlisting of property, the Cabarrus County assessor in early 1988 retained a firm on a percentage-fee basis to conduct tax audits. *See* N.C. Gen. Stat. § 105-296(a). This contract was approved by the Board of County Commissioners. *See id.* § 105-299. A

short time after the auditors were employed, the county assessor (not the auditors) selected the businesses to be audited. The assessor had no financial or personal interest in the outcome of any audit or discovery. An estimated 600 business personal property audits were directed by the county assessor, and in approximately two-thirds of the audits, the taxpayers had reported their costs accurately. Approximately five percent of the taxpayers had over-reported their costs and were informed that they were entitled to refunds. The remainder had under-reported their costs and were sent discovery notices.

In the fall of 1988, the assessor wrote Philip Morris to request that its internal cost and asset records be made available for an audit. Despite several verbal and written requests over a period of nine months, Philip Morris refused to make its records available. The assessor then issued a jeopardy assessment to assure that the statute of limitations would not expire.[1] Philip Morris' attorneys finally sent copies of the needed records in December 1989, over a year after they were requested.

These records revealed that, for each year between 1984 and 1989, Philip Morris had listed less than one-half of the costs for its business personal property located in Cabarrus County, rather than the full actual costs as required. Indeed, before the North Carolina Property Tax Commission, Philip Morris stipulated to cost figures that showed that it had listed less than one-half of its costs. By

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[1] This assessment was for the total value of the property. The actual tax would have been approximately one percent of the assessed amount.

underlisting its business personal property, Philip Morris avoided over one million dollars per year of property taxes in Cabarrus County.[2]

In early 1990, the auditors completed their review of Philip Morris' records and filed a preliminary report of the Philip Morris underlistings to the assessor. The Cabarrus County assessor reviewed this report and then met with Philip Morris officials, attorneys and other representatives on several occasions. The Cabarrus County assessor then made his decision to issue the subject discovery assessment on May 8, 1990. The assessor's discovery assessment was less than the auditor's report, because Philip Morris persuaded the assessor that certain property was exempt from taxation or otherwise should not be included in the discovery.

After an appeal hearing was concluded before the local equalization and review board, the state Property Tax Commission by a 3-2 vote ruled that the discovery was null and void because the auditors' percentage-fee contract violated state public policy. Prior to the ruling, the parties submitted no affidavits and no testimony; the ruling was based on Philip Morris' motion and argument by counsel. The Court of Appeals affirmed without holding oral argument. On December 3, 1993, the Supreme Court of North Carolina reversed the decision of the Court of Appeals, ruling that the auditors' percentage fee contract did not violate public policy and thus the discovery was valid. The Supreme Court remanded the case for

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[2] Philip Morris' financial statements reflect that its operating profit on the cigarettes from the Cabarrus County facility substantially exceeds one *billion* dollars per year.

a hearing on the merits by the Property Tax Commission. Such hearing commenced May 9, 1994, and while the evidentiary hearing has been concluded, a final decision of the Commission has not been rendered as of this date.

Before both the North Carolina Court of Appeals and the Supreme Court of North Carolina, Philip Morris pressed its due process argument that the auditor should be viewed as a judicial official. Philip Morris did not, however, argue that the auditor should be viewed as a prosecutorial official.

SUMMARY OF ARGUMENT

Petitioner, one of the largest and most profitable consumer products companies in the world, seeks to continue avoiding its local tax obligations by asking this Court to decide if due process prevents a local government from hiring a private company as tax auditor and compensating it on a percentage-fee basis. Respondent Cabarrus County used such a system out of necessity because it had no budgeted funds to hire staff auditors. The system has benefitted the County by uncovering underlisting of business personal property that had previously deprived the County of substantial revenue. Such revenue funds county schools, social services, and municipal projects.

There are strong reasons to conclude that this issue does not require the Court's attention, particularly as it is presented in this case. First, the issue is notably uncontroversial. No court has found a due process violation in such circumstances. Indeed, only one other state court

has even addressed this due process issue, and that court, like the court below, found no constitutional violation.

In apparent recognition that the question presented does not involve a conflict or an issue of practical importance, petitioner contends that the issue is one of at least academic interest. This contention is undermined by *Tumey v. Ohio*, 273 U.S. 510, 535 (1927), where this Court recognized that offering rewards to citizens for their aid in the apprehension of wrongdoers raised no due process difficulties. The same rule applies here. The limited function played by the tax auditor in Cabarrus County and the multi-layered review process leave no doubt that the procedures here satisfied the requirements of due process.

Finally, even if there were serious questions as to the constitutionality of the procedures here – a proposition that respondent emphatically rejects – this case would present a particularly inappropriate vehicle for resolving them. The decisions below gave little discussion to the constitutional issue. The issue was presented and decided without any factual record on significant aspects of the auditor's duties, even though there were disputes as to the nature of those duties. The lack of jurisprudential guideposts combined with unresolved factual issues makes this case a poor candidate for review.

Even more important, this case does not appear to satisfy the finality requirement of 28 U.S.C. § 1257. Petitioner is continuing to contest its tax liability on non-constitutional grounds in state proceedings, and the merits of the case have not been resolved. The case does not fall within any established exception to the finality

requirement. Even if this apparent lack of finality did not deprive this Court of jurisdiction, it would argue against use of this Court's limited resources here, since it is possible that further proceedings will moot the issue.

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW DOES NOT MERIT REVIEW, SINCE IT INVOLVES NEITHER A CONFLICT NOR AN IMPORTANT FEDERAL QUESTION.

The established grounds for discretionary review – a conflict in the case law or a federal question of exceptional importance – are simply not present in this case. *See* Sup. Ct. R. 10.1. Instead of pointing up a sound basis for review, the authority cited by petitioner tends to show that the due process implications of the compensation of tax auditors is an issue involving no controversy. *See* Pet. at 9, 20.

In fact, of the several state cases cited by petitioner, only one case even addressed the argument that due process precluded paying tax auditors on a contingency basis – and that case unceremoniously rejected the argument. *Union Pacific Resources Co. v. State*, 839 P.2d 356, 377 (Wyo. 1992). The other state cases on which petitioner relies did not address constitutional issues, but considered whether various compensation arrangements offended public policy. Of those cases, only one (in Georgia) rejected a contingency arrangement as contrary to

public policy.[3] There is plainly no conflict on the constitutional issue presented here.

Thus there is no apparent basis for a grant of certiorari. There is not even an arguable conflict in the lower court decisions, and the lack of controversy indicates that there is not an issue of exceptional importance. Moreover, as explained in the next section, the decision below is entirely consistent with this Court's prior decisions.

II. THE COMPENSATION OF TAX AUDITORS HERE DID NOT VIOLATE THE REQUIREMENTS OF DUE PROCESS.

The lack of controversy over whether due process proscribes compensating tax auditors on a percentage-fee basis is perhaps explained by the fact that the question is not a difficult one. This Court spoke to it indirectly in *Tumey v. Ohio*, 273 U.S. 437, 510 (1927). In *Tumey*, the Court had before it statutes that allowed a mayor acting as a judge to be compensated out of the fines he imposed. The statutes also provided for compensating of deputy marshals, detectives, and others by awarding a percentage of fines collected. *Id.* at 439. Although the Court held that paying the mayor, acting as judge, based on the fines

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[3] *Sears, Roebuck & Co. v. Parsons*, 260 Ga. 824, 835, 401 S.E.2d 4, 5 (1991). *But see General Electric Co. v. City of Bridgeport*, CV93 30 45 71 S (Conn. Super. Ct. Dec. 16, 1993); *Dillon Stores, Inc. v. Lovelady*, 253 Kan. 274, 280, 855 P.2d 487, 491 (1993); *General Motors Corp. v. State Tax Comm'n*, 200 Mich. App. 117, 121, 504 N.W.2d 10, 12 (1993), *appeal dismissed*, 509 N.W.2d 157 (Mich. 1993).

he imposed was a violation of due process, it also explicitly recognized in dicta that contingency arrangements in other contexts raise no due process concerns.

The *Tumey* Court made clear that the Constitution does not generally prohibit States from paying for the assistance of private citizens or from paying them on a percentage-fee basis:

> [T]he Legislature of a state may and often ought to stimulate prosecutions for crime by offering to those who shall initiate and carry on such prosecutions rewards for thus acting in the interest of the state and the people. The Legislature may offer rewards or a percentage of the recovery to informers. . . . It may authorize the employment of detectives.

273 U.S. at 445.

The compensation system here is, if anything, less problematic than the rewards and contingency arrangements approved in *Tumey*. As described in the Statement of the Case above, the auditors in Cabarrus County merely make a report to the assessor. This report is based on the taxpayer's own records. The assessor, in turn, considers not only the report, but also any information made available by the taxpayer in meetings between the assessor and the taxpayer. *See* N.C. Gen. Stat. § 105-312(d). The assessor – not the auditor – determines whether to make a discovery assessment and the amount of the discovery. *See id.* § 105-312(b).

The assessor's decision is subject to several levels of review. First, the taxpayer may appeal a discovery assessment to the county Board of Equalization and Review. *See*

N.C. Gen. Stat. § 105-322. If the taxpayer is dissatisfied with that Board's decision, it may appeal to the state Property Tax Commission for a *de novo* evidentiary hearing and decision. *See id.* § 105-288. Next, the taxpayer may appeal of right to the North Carolina Court of Appeals. *See id.* § 105-345. Finally, the taxpayer may seek review by the Supreme Court of North Carolina. *See id.* §§ 7A-30, 7A-31. Thus there are ample procedural protections built into the assessment process. The limited role played by the auditor and the multiple safeguards in connection with any assessment put to rest any due process concerns. *See Mathews v. Eldridge*, 424 U.S. 319 (1976).

At bottom, petitioner's due process argument rests on the proposition that contingent fees involve intolerable risks – a proposition with no support either in hard facts or in intuition. Contingency arrangements are commonplace throughout our society. They are well accepted in certain kinds of attorney-client relationships, in business, and in the reward situation described in *Tumey*. The widespread use of contingency arrangements is explained by their considerable benefits, of which this case provides a dramatic example. Without the compensation at issue here, a rural county would not have uncovered a massive tax underlisting by a large corporation.

Petitioner attempts to argue that a tax auditor is equivalent to an assessor, and the assessor is a judicial or prosecutorial official subject to strict due process requirements. Pet. at 15-16. This chain of reasoning breaks at the first link. As explained above, the auditor's role is clearly distinct from the assessor's. The assessor issues the discovery and has no financial interest in the outcome of any

audit. To equate the auditor with the assessor is like equating a detective with a judge or prosecutor.

Moreover, there is ample reason to doubt that even the assessor (as distinguished from the auditor) is a judicial or prosecutorial official. For example, this Court, in its most recent pronouncement on the subject, expressly stated that "[t]he governmental function of fixing the value for tax purposes has rarely, if ever, been a judicial function." *Arkansas Corp. Comm'n v. Thompson*, 313 U.S. 132, 142-43 (1941).[4] There is little force, then, to the argument that the tax auditor in this case should be subject to the same standard as the judicial officer in *Tumey*.

With respect to prosecutors, petitioners failed to raise below any argument regarding prosecutorial due process. *See, e.g., Illinois v. Gates*, 462 U.S. 213, 217 (1983) (declining to decide issue not previously presented in state court); *Delta Air Lines, Inc. v. August*, 450 U.S. 346, 362

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[4] Petitioner relies on isolated language from a case from more than half a century prior to *Arkansas Corp. Comm'n – Hagar v. Reclamation District No. 108*, 111 U.S. 701 (1884). In *Hagar*, the Court in passing referred to the duties of a tax assessor as judicial. *Id.* at 710. Nothing turned on this characterization, however.

In fact, the *Hagar* Court made clear that the due process requirements of notice and an opportunity to be heard did not apply to the decision of the assessor, but rather to administrative or judicial review of that decision. *Id.* at 710-11. That is, *Hagar* did not treat the assessor's decision as equivalent to that of a judge. In view of this treatment and in view of the subsequent discussion of the role of the assessor in *Arkansas Corp. Comm'n*, *Hagar*'s reference to the assessor's judicial activities sheds little light on the due process limits on compensation of assessors – much less on compensation of auditors.

(1981) (same). This Court in *Marshall v. Jerrico, Inc.*, 446 U.S. 238 (1980) found that the requirements for satisfying due process were less rigorous than for judges, but recognized the possibility that compensation of prosecutorial officials could in some future case raise constitutional problems. Whatever the due process limits on prosecutors might be, they would give little guidance here, because of the obvious distinctions between tax assessors and prosecutors. Moreover, the conduct of an assessor (as opposed to tax auditor) is not even at issue here. Petitioner's failure to raise this issue previously is itself a strong indicator of its lack of substance.

In sum, this Court's prior decisions either support the decision below (*Tumey, Arkansas Corp. Comm'n*) or have no bearing on it (*Marshall*). The soundness of the decision below argues against review here.

III. THE LACK OF A WELL-DEVELOPED RECORD AND LACK OF FINALITY MAKE REVIEW HERE PARTICULARLY INAPPROPRIATE.

In addition to the unimportance of the issue and the lack of merit to petitioner's argument, other considerations also argue against a grant of certiorari here. There was hardly any legal discussion in the decisions below. This lack of reasoning is not remedied by case law elsewhere; rather, there is almost no jurisprudence on the issue presented. The undeveloped state of the law not only suggests the lack of real significance to the issue, but also suggests that consideration of the issue would be at best premature.

Just as important, the issue presented here was decided below with hardly any factual development. There was no evidence presented in court or in administrative hearings as to the activities of tax auditors in Cabarrus County. Instead, petitioner relied on its counsel's representations as to those activities. These representations were disputed in certain respects (though similarly without record evidence) by counsel for respondent. Disputed issues included whether certain taxpayers were unfairly singled out for audits and what role the auditor played in the discovery process. The lack of a clear factual record and unresolved factual issues make this case a poor vehicle for clarifying any arguable uncertainty in the law.

Finally, the ongoing nature of the proceedings here argues against review. The decision below should not be deemed to satisfy the finality requirement of 28 U.S.C. § 1257, since the case was remanded for further state proceedings. To be sure, petitioner attempts to rely on the exception set forth in *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 480, 506 (1975) (majority and Rehnquist, J., dissenting) for federal questions "bound to survive . . . regardless of the outcome of future state-court proceedings." The question here, however, is not "bound to survive." In the remand proceedings, petitioner has attempted to present state-law arguments that, if accepted, would eliminate liability and moot the federal issue.

Of the four categories set out in *Cox*, the exception that comes closest to fitting this case is the fourth, for cases "with further proceedings pending in which the party seeking review here might prevail on the merits on

nonfederal grounds, thus rendering unnecessary review of the federal issue by this Court, and where reversal of the state court on the federal issue would be preclusive of any further litigation. . . . " 420 U.S. at 482-83. This exception applies, however, only "if a refusal immediately to review the state court decision might seriously erode federal policy. . . . " *Ibid.* Thus in *Flynt v. Ohio*, 451 U.S. 619, 622 (1981), this Court declined to apply the fourth *Cox* exception in the context of an Equal Protection Clause challenge alleging selective prosecution because "resolution of this question can await final judgment without any adverse effect upon important federal interests."

The same is true here: there is no important federal policy that would be undermined by putting off review until a final determination in the state proceedings. Even leaving aside the apparent lack of jurisdiction here, the possibility that petitioner will eventually prevail argues against a grant of certiorari. Particularly when added to the other strong reasons not to review this case (the lack of a conflict, lack of an important issue, and the soundness of the decision below), denial is appropriate since the case might become moot.

CONCLUSION

This case presents no conflict among state courts, no question of unusual importance, and no other reason to merit a place on this Court's docket. Even if there were some reason to examine the question presented, this case would present a number of problems, because of the

undeveloped state of the legal and factual record. Particularly given that state proceedings are still in progress, review here is unjustified. For all these reasons, respondent requests that the petition be denied.

This the 27 day of May, 1994.

Respectfully submitted,

ROBERT H. TILLER
(Counsel of Record)
CHARLES C. MEEKER
PARKER, POE, ADAMS &
BERNSTEIN L.L.P.
One Exchange Plaza
Post Office Box 389
Raleigh, North Carolina 27602
(919) 828-0564

DAVID L. TERRY
BLAKENEY & ALEXANDER
3700 NCNB Plaza
Charlotte, North Carolina 28280
(704) 372-3680

Attorneys for Respondent
Cabarrus County